

November 27, 2018

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Re: Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures

Ladies and Gentlemen,

The American Bankers Association¹ (ABA) appreciates the opportunity to comment on the Agencies' proposal entitled "Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures" (HVCRE Proposal). The HVCRE Proposal would amend the regulatory capital rule by revising the definition of HVCRE exposure to conform to the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan," in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Additionally, to facilitate the consistent application of the revised HVCRE exposure definition, the agencies propose to interpret certain terms in the revised HVCRE exposure definition generally consistent with their usage in other relevant regulations or the instructions to the Consolidated Reports of Condition and Income (Call Report), where applicable.

¹ The American Bankers Association is the voice of the nation's \$17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits and extend more than \$9 trillion in loans.

In 2013, the banking agencies finalized the Basel III capital standards. As part of that standard, the banking agencies promulgated a new definition of HVCRE exposures and applied a heightened 150% risk weight to these HVCRE exposures. As the agencies acknowledged, the application of HVCRE definitions and loans qualifying were inconsistent due to lack of clarity arising from many different lending scenarios and interpretations of the rule. Clarification from Congress in the passing of the EGRRCPA coupled with this proposed rulemaking sets consistent industry standards.

Section 214 of the EGRRCPA sets a limit on the banking agencies' ability to apply a higher risk weight to HVCRE exposures. Specifically, Section 214 states:

The appropriate Federal banking agencies may only require a depository institution to assign a heightened risk weight to a high volatility commercial real estate (HVCRE) exposure...under any risk-based capital requirement if such exposure is an HVCRE ADC loan.

Section 214 then defines HVCRE ADC as a substantially narrower subset of HVCRE exposures. As a result, Section 214 excludes most HVCRE exposures from a heightened risk weight. In fact, many ABA members who are major ADC lenders would see only a small fraction, if any, of their portfolios subject to the heightened risk weight category.

While this is an extremely positive step, the definition of HVCRE ADC is still complex and a burden for banks to define at origination and track. We note that EGRRCPA does not require the banking agencies to apply a heightened risk weight to HVCRE ADC exposures. Rather, EGRRCPA simply prohibits the banking agencies from applying a heightened risk weight to HVCRE exposures unless the exposures also meet the HVCRE ADC loan definition. ABA supports efforts to simplify and improve the current regulatory capital framework, and we appreciate this important step by the Agencies in this important process, positive both for better supervision and improved bank management. However, considering the complexity of the HVCRE ADC definition and the small fraction of exposures that will be captured by that definition, we believe that the HVCRE ADC should not be treated as a separate class so that all ADC lending is subject to the general 100% risk weight and wholesale correlation factor.

Should the agencies move forward with a final standard that includes a distinct category for HVCRE, we offer the following responses to the proposal's questions.

Question 1: The agencies invite comment as to whether the final rule should require reevaluation of ADC loans originated on or after January 1, 2015 under the revised HVCRE exposure definition. What are the advantages and disadvantages of requiring reevaluation? What alternative treatments, if any, should the agencies consider?

Reevaluation of ADC loans originated on or after January 1, 2015 under the revised HVCRE exposure definition should be optional to minimize burden on institutions.

Question 2: The agencies request comment on whether the terms “secured by land or improved real property,” “primarily finances,” and “income-producing real property” are clear or whether further discussion or interpretation would be needed. The agencies also request comment on whether their proposed interpretations of these terms are appropriate and whether loans secured by vacant land except agricultural land should be included in the scope of the revised HVCRE exposure definition.

The legislation does not define vacant land as being considered to be HVCRE regardless of the scope, therefore raw land or vacant land should not automatically be included. Loans secured by land or improved real property, including raw land and vacant land, should only be included if it satisfies all the three criteria of the HVCRE ADC real property definition; “primarily finances the ADC of real property”, “has the purpose of providing financing to ADC or improve such real property into income-producing real property” and “is dependent upon future income or sales proceeds from, or the refinancing of, such real property for the repayment of the credit facility”.

Question 3: The agencies invite comment on whether their proposed interpretations of the scope of the one- to four-family residential properties exclusion for purposes of the revised HVCRE exposure definition are appropriate and clear, including which types of townhomes, condominiums, cooperatives, and mobile home-related loans are excluded. The agencies also invite comment on whether it is appropriate to include one- to four- family lot development loans within the scope of this exclusion.

We agree with this exclusion definition, however feel the exclusion should be expanded to also include individual townhomes and condominiums developed as 1-to-4 units residential to be considered for exclusion from HVCRE definition.

We strongly agree the test should remain the factor in determination, however, would like to point to the call report as support for the condos and townhouses if developed for 1-to-4 family development. The proposed capital rule interpretation creates a difference in HVCRE classification for condominium construction loans between the capital rule and Call Report and FR Y-9C current instructions. The proposed capital rule interpretation indicates that condominium construction loans should be included for purposes of HVCRE exposure as the capital rule proposal aligns with the interagency real estate lending standards. These standards state that the construction of condominiums and cooperatives are multifamily construction.

For example: On the current Call Report and FR Y-9C instructions, condominium construction loans are excluded from HVCRE exposure on Schedule RC-R/HC-R. The instructions explicitly exclude loans that are reported in line item 1.a. (1) 1-4 family residential construction loans on Schedule RC-C/HC-C, which is where condominium construction loans are currently reported on Schedule RC-C/HC-C. The capital rule proposal notes that the agencies considered alignment with the Call Report instructions definition of a one-to-four family residential property for purposes of the HVCRE exposure exclusion. However, they did not use the Call Report’s definition and highlight that there is a difference. We do not believe the agencies intend to have differences between loans reported as HVCRE on FFIEC 101 and loans reported as HVCRE on the Call Report and FR Y-9C Schedule RC-R/HC-R. Loans classified as HVCRE should be consistent across the capital rules, Call Report and FR Y-9C schedules and instructions. We

recommend that the relevant call reporting instructions for condominium construction loans should also apply for HVCRE capital rule purposes to ensure consistency in reporting loans considered to be HVCRE. If the agencies do not accept this recommendation and adopt the capital rule revisions as proposed, then the agencies should make clarifying revisions to the Call Report and FR Y-9C instructions for HVCRE exposure treatment of loans financing construction of condominiums to align with the revised capital rule HVCRE definition for there to be consistent HVCRE exposure populations reported across the FFIEC 101, Call Report and FR Y-9C.

Question 4: The agencies invite comment on whether the proposed interpretation of the term “community development” in the revised definition of HVCRE exposure is appropriate and clear, or whether it requires further discussion or interpretation.

We agree with the proposed interpretation of the term “community development.”

Question 5: The agencies invite comment on whether their proposed interpretation of the term “agricultural land” in the revised definition of an HVCRE exposure is appropriate and clear, or whether it requires further discussion or interpretation.

We agree that the term “agricultural land” in the revised definition of an HVCRE is clear.

Question 6: The agencies invite comment on whether the term “permanent financings” in the revised definition of an HVCRE exposure is clear or whether further discussion or interpretation would be appropriate.

We agree that the term “permanent financings” in the revised definition of an HVCRE exposure is clear.

Question 7: The agencies invite comment on whether their proposed interpretation of the 15 percent contributed capital exclusion is appropriate and clear or whether further discussion or interpretation would be appropriate. What other issues, if any, relating to the contributed capital exclusion require interpretation? What issues are there relating to the contribution of cash, unencumbered readily marketable assets, real property or improvements that require interpretation? What expenses should or should not qualify as development expenses and are there any other issues relating to paid development expenses that would require interpretation? The agencies also invite comment on whether it is appropriate and clear that the cross-collateralization of land in a project would not be included as contributed real property for purposes of the contributed capital exclusion.

Should the agencies maintain an HVCRE ADC definition, we believe that two areas still required additional clarification.

- a.) It is unclear if a borrower’s contributed cash from funds that are borrowed from another financial institution counts as 15% contributed capital is allowed under this rule.
- b.) Clarification that additional pledged or cross-collateralization of land in a project cannot be included as contributed real property for purposes of the contributed capital.

Question 8: The agencies invite comment on whether the proposed interpretation on the required use of an as-completed value appraisal for purposes of the contributed capital exclusion is appropriate and clear and whether there are additional issues relating to the appraisal requirement for purposes of the contributed capital exclusion that need interpretation.

We believe that the interpretation on the required use of an “as-completed” value appraisal for purposes of the contributed capital exclusion is generally clear, however the member banks have identified an “as-is” appraisal need/issue. An example, when financing a development plan only for Phase 1 & 2 on 40 acres, but 100 acres were purchased, there is no “as-completed” for the remaining 60 acres, which should allow for an “as-is” appraisal for the remaining land.

Question 9: The agencies invite comment on whether their proposed interpretation of the term “project” is appropriate and clear, and whether the term “project” requires further discussion or interpretation.

The proposed interpretation of the term “project” requires some clarification regarding the need for appraisals on multiphase projects. Building projects often have multiple phases. The agencies should clarify that if a bank is lending to the entire project, even if there are multiple phases, the bank will be still be allowed to have one appraisal covering the entire project. Banks should not be required to get an appraisal for each phase. Similarly, if only financing one or two phases, of a “multi-phase project” the appraisal should only be needed for the phases being financed, not the entire project.

Question 10: The agencies invite comment on whether additional terms included in the text of section 214 of the statute that are not discussed above are ambiguous or need interpretation? The agencies invite comment on what, if any, operational challenges would banking organizations generally expect when determining whether an HVCRE exposure under the proposed revised definition can be reclassified as a non-HVCRE exposure?

We believe that the text of section 214 of the statute for reclassifying loans as a non-HVCRE exposure are clear and do not require further interpretation.

Question 11: The agencies invite comment on the potential advantages and disadvantages of incorporating the agencies' interpretations of the terms used in the revised HVCRE exposure definition into the rule text or in another published format. What type of information should be included? What, if any, additional aspects of the revised HVCRE exposure definition, or its application and usage, should be included?

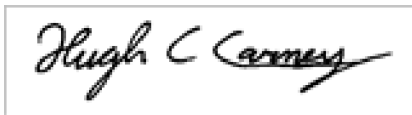
The banking agencies should clarify which, if any, of the existing HVCRE FAQs are relevant after the passage of the EGRRCPA, and that clarification should be addressed as part of the formal rule when published. The member banks request that any existing HVCRE FAQs be amended or confirmed as part of the rule if applicable.

ABA appreciates the opportunity to comment on this proposal. If you have any questions about the content of this letter please contact Sharon Whitaker at 202-663-5321 or Hugh Carney at 202-663-5324.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Sharon Whitaker', written over a horizontal line.

Sharon Whitaker
Vice President
Commercial Real Estate Finance
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A handwritten signature in dark ink, appearing to read 'Hugh C. Carney', enclosed within a rectangular box.

Hugh C. Carney
Vice President
Capital Policy